

STATE OF MAINE  
PUBLIC UTILITIES COMMISSION

Docket No. 2004-167

June 23, 2004

CENTRAL MAINE POWER COMPANY  
Annual Price Change Pursuant to the  
Alternative Rate Plan (Post Merger)

ORDER ON  
CONTESTED ISSUES

WELCH, Chairman; DIAMOND and REISHUS, Commissioners

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**I. SUMMARY**

In this Order, we reject Central Maine Power Company's (CMP's) proposal to revise its rates as part of this year's annual ARP price change to reflect revisions to prior years' inflation indices. We also refer back to the Hearing Examiner, for further consideration, CMP's proposal to defer as incremental costs, certain internal costs associated with the removal of its transformers containing PCBs under 38 M.R.S.A. § 419-B, as well as CMP's calculation of the return component on the replacement transformers.<sup>1</sup>

**II. PROCEDURAL HISTORY**

See Appendix A

**III. BACKGROUND**

**A. CMP's Annual Filing**

On November 16, 2000, the Commission approved a second alternative rate plan (ARP) for Central Maine Power Company (CMP or the Company).<sup>2</sup> *Central Maine Power Company, Request for Approval of Alternative Rate Plan (Post-Merger) "ARP 2000", Order Approving Stipulation*, Docket No. 99-666 (Nov. 16, 2000). Under the terms of ARP 2000, CMP's rates are adjusted annually, each July, pursuant to the following price-index formula:

PI = Inflation index – productivity offset +/- (mandated costs +/- net capital gains and losses) +/- expiring amortizations = earnings sharing – any service quality penalties.

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<sup>1</sup> In a companion order issued today, we approve a stipulation that resolves the uncontested issues in this proceeding. *Order Approving Stipulation and Implementing Annual Price Change*, Docket No. 2004-167 (June 23, 2004). That Stipulation does not address the issues considered in this Order.

<sup>2</sup> CMP's first ARP was approved in *Central Maine Power Company, Proposed Increase in Rates, Detailed Opinion and Subsidiary Findings*, Docket No. 92-345(II) (Jan. 10, 1995). CMP's first ARP is now commonly referred to as "ARP 95."

On March 15, 2004, CMP submitted its annual ARP filing which contained its proposed price change to take effect on July 1, 2004. In its filing, CMP proposed an overall downward adjustment to rates of 0.53%. This adjustment was comprised of an inflation index of 1.55%; a productivity offset of -2.75%; no recoverable mandated costs; an inflation index adjustment of 0.61%; other items (including transformer replacement costs) of -0.91%; and the removal of one-time items from last year's ARP price change of 0.97%. CMP noted that its 2003 fourth quarter GDP-PI number was preliminary and that it would update its filing to reflect the final GDP-PI number which it expected to be released in March 2004. The Company subsequently provided its updated GDP-PI calculations which resulted in an increase in the inflation index to 1.62%.

As described in the Procedural History, Appendix A of this Order, the parties have resolved all issues raised by the Company's filing with the exception of the Company's proposal to incorporate changes to past GDP-PI calculations as part of this price change, as well as the Company's classification of costs as incremental for its PCB transformer replacement program and, thus, eligible for deferral and recovery from ratepayers. These issues requiring adjudication are described below.

B. The Inflation Index Issue

In addition to the change in the annual inflation index for 2003, CMP as part of this filing, proposed a 0.61% adjustment in rates to reflect a comprehensive revision to GDP and GDP-PI calculations done in December 2003 by the Bureau of Economic Analysis (BEA). The revision resulted in a restatement of the inflation indices used since 1929. According to CMP, the new method of calculating the GDP includes a number of definitional and statistical improvements that provide a better measurement of the U.S. economy. The revised BEA methodology results in a GDP-PI change of 2.37% for 2001 compared to the 1.87% number used to calculate rates based on the prior methodology, while the new numbers for 2002 yield a 1.45% change compared to the 1.34% used to determine rates as part of the 2003 price change.<sup>3</sup>

C. Transformer Replacement Issue

As part of our Order in *Maine Public Utilities Commission, Investigation of Central Maine Power Company's Revenue Requirements and Rate Design (Phase II-B)*, Order Approving Stipulation, Docket No. 97-580 (Feb. 24, 2000), the Commission authorized CMP to defer for future recovery, the incremental costs of complying with 38 M.R.S.A. § 419-B, which requests phasing out the use of old transformers that are potential sources of pollution. This statute sets out the State's goals for the removal of transformers owned by public utilities that contain PCBs in concentrations at or above 50 parts per million. For such transformers within 100 feet of any surface water or an elementary or secondary school, the removal goal date is

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<sup>3</sup> BEA's comprehensive revision also resulted in a change in the baseline GDP-PI numbers. The new baseline numbers are not contested here and serve as the basis for calculating this year's annual GDP-PI percentage change.

October 1, 2005. For all other transformers with PCB concentrations above the stated threshold level, the goal date for removal is October 1, 2011. The statute states that these goals are voluntary and that a public utility is not required to meet them.

As part of its 2003 annual ARP filing, CMP proposed to include the costs it had incurred replacing transformers as a result of L.D. 665 as of December 31, 2002 as part of the ARP 2000 distribution price change scheduled for July 1, 2003. These costs were separated into two categories, (i) a one-time increase of \$1,154,400 to reflect costs deferred through December 31, 2002 (including depreciation and carrying costs through June 2003), and (ii) an ongoing revenue requirement increase of \$246,869 for transformer investments made through December 31, 2002. Subsequent to its annual filing, CMP realized that it had failed to include the return requirement and depreciation<sup>4</sup> associated with the removal costs of the PCB transformers. The removal costs in question were comprised of \$150,000 of depreciation expense and \$41,789 of return requirement associated with removal costs.

The parties to the Stipulation which resolved last year's annual ARP proceeding agreed that CMP should be allowed to include these removal costs as part of its 2003 rate change. However, the parties reserved the right to investigate in the 2004 annual ARP proceeding the issue of whether these removal costs were truly incremental. If after further review it were determined that the removal costs were not incremental costs, CMP agreed that it would calculate a one-year refund of the disputed amount to be included in distribution rates effective July 1, 2004. *Central Maine Power Company, Annual Review (Post-Merger) ARP 2000, Order Approving Stipulation*, Docket No. 2003-179 (June 24, 2003).

As part of this year's annual ARP filing, CMP proposed to recover over a one-year period \$468,000 of deferred costs , and \$161,000 of additional ongoing revenue requirements. Of these additional costs requested for recovery, \$150,000 were related to removal costs.

#### IV. POSITIONS OF THE PARTIES

##### A. CMP

##### 1. The Inflation Index Adjustment Issue

CMP states in its brief that the revised GDP-PI estimate released by the BEA this past December relies on more timely data, enhanced statistical analysis and a better weighting and measure of the components that make up the U.S. economy. BEA's recent changes include:

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<sup>4</sup> The term depreciation as used by CMP here means the amortization of deferred costs and is not depreciation of a capital asset as the term is usually used.

- A more complete and accurate measure of insurance services that results from estimating implicit services provided by property and casualty insurance companies;
- An improved measure of banking services that identifies services received by borrowers as well as by depositors;
- A new treatment of government that recognizes that governments produce services and that goods and services purchased by governments are intermediate inputs;
- An expanded definition of national income that includes all net incomes earned in production, a definition more consistent with international guidelines;
- The incorporation of information from the 1997 benchmark input-output accounts;
- For recent periods, a new adjustment to corporate profits estimates that makes use of additional information on the expenses associated with employee stock options;
- New BEA price indexes for the deflation of nonresidential structures and of photocopying equipment that account for changes in key characteristics of these products;
- New methodologies that provide better estimates of purchases of used motor vehicles and a better allocation of exports and imports of autos and trucks;
- The use of more reliable source data for the estimation of state and local current taxes; and
- Moving the reference year for chain-type quantity and price indexes and for chained-dollar estimates from 1996 to 2000 and showing industry estimates on the basis of the North American Industry Classification System.

The result of these changes is a more accurate inflation index, which CMP asserts is not disputed. Without reflecting the impact of the BEA's revised and more accurate inflation rates for 2001 and 2002 as an adjustment to this year's annual price change, the inaccuracies in the inflation index will be compounded as CMP's rates change during the remaining life of ARP 2000. Without the proposed adjustment to the Inflation Index, CMP claims that it will under-recover \$4.5 million from July 1, 2004 through the time ARP 2000 expires on December 31, 2007.

In its brief, CMP argues that it must be allowed to use the corrected GDP-PI numbers for 2001 and 2002 to recalculate rates at this point since the ARP regulatory compact is predicated on the use of the most accurate inflation index

available. In support of this position, CMP points to the testimony of its witness Dr. Kenneth Gordon in the ARP 2000 proceeding and the testimony of Dr. Marvin Kahn submitted on behalf of the Advocacy Staff in Docket No. 92-345(II), CMP's first ARP proceeding. In his testimony in Docket No. 92-345(II), Dr. Kahn argued that the GDP-PI was a superior index to the Consumer Price Index for Urban Areas (CPI-U) in that the GDP-PI was more current, was a broader based index than the CPI-U, was more representative of price changes throughout the economy and thus was more appropriate for determining the impact of inflation on CMP's costs. Thus, CMP argues, the parties have always recognized that for the price cap formula to work properly and to allocate risks fairly, it is imperative that the most accurate inflation index be used to capture the inflationary pressures faced by CMP.

The Company argues that since ARP 2000 does not contain language restricting the inflation index calculation to a date certain, CMP should be allowed to update the index as proposed. In support of this position, CMP points to three Purchase Power Agreements (PPAs) with different qualifying facilities which contain specific dates as to when the inflation index will be calculated. CMP notes that in all of its previous ARP 2000 annual filings, CMP initially used the BEA "preliminary" fourth quarter GDP-PI estimate (typically released in late February) and then updated the calculation during the course of the annual ARP proceeding with the "final" estimate which is published at the end of March. CMP does not capture the change from this "final" estimate to the BEA's "actual" fourth quarter GDP-PI estimate since that revision occurs in August after the July 1 price change occurs, is relatively small in magnitude, and is captured in the next price change when the year-to-year difference in the GDP-PI is calculated.

Finally, CMP argues that contrary to any assertions by the OPA, no change to the ARP's productivity offsets is warranted if the Commission revises the inflation index as requested. CMP argues that unlike the inflation index, the annual productivity offsets were set as matter of extensive negotiations. The negotiated productivity offsets were not driven by the agreed-to inflation index methodology but rather were driven by the decisions on earnings sharing on merger savings and the term of the ARP. ARP 2000 already includes high productivity offsets in place of upper-end earnings sharing. Any argument that even higher productivity offsets would have been included had the parties known of the GDP-PI revisions at the time of the ARP 2000 negotiations is absurd, according to CMP.

## 2. Transformer Replacement Issue

In its brief, CMP argues that it has been diligent in its efforts to meet the goals stated in 38 M.R.S.A. § 419-B. In fact, CMP's efforts have been so successful that removal of the Priority S and Priority W transformers (those located near schools and waterways) is ahead of schedule. CMP has fully embraced the program with the understanding that it would recover the costs it incurred.

CMP argues that the removal costs it has identified are truly incremental. First, CMP states that the rates established in Docket No. 97-580 used a

1996 Test Year, with attrition to 2000. In 2000, CMP hired approximately 20 additional line workers whose positions were not included in CMP's revenue requirement. These line workers were added to address both increased workload (including the transformer replacement program) and changes in work rules that addressed safety issues. Therefore, it is not reasonable to contend that CMP is already fully recovering in rates all of its internal labor costs, particularly the internal labor costs related to the transformer replacement program. In addition, there is an opportunity cost to CMP since line workers are not available to perform routine tasks when they are working on the transformer replacement program. CMP uses contractors to supplement its line worker employees. Denying CMP recovery of its full incremental costs would restrict the flexibility that CMP has to mix its work force with contractors for maximum productivity. CMP notes that it could direct the contractors to perform only transformer replacement, thus assuring that no CMP labor is involved. CMP has not taken that approach, however. Rather, CMP has optimized its line crews and contractors without regard to this cost recovery issue.

Finally, CMP notes that there are other costs that CMP has incurred as a result of this program, such as executive planning and management supervision, but CMP is willing to forego recovery of those costs. The costs which CMP has not included in its cost recovery requests include administrative costs of approximately \$122,000 through December, 2002. CMP admits, however, that these costs are not incremental in that CMP would not avoid them absent the program.

B. OPA

1. The Inflation Index Adjustment Issue

The OPA argues that the ARP 2000 Stipulation clearly sets forth the procedure to be used in calculating the inflation index. Specifically, the Stipulation provides that the annual inflation index used in the price index formula will be calculated as the percentage change in the GDP-PI of the fourth quarter of the most recent year from the fourth quarter of the preceding year. The OPA argues that there is nothing ambiguous, unclear, murky or misleading about the phrases "most recent year" and "preceding year." As under contract law, the language of the Stipulation should be given its plain meaning, and there is no need to go beyond the unambiguous language of the Stipulation.

If the parties had intended to update the inflation rates for past years in the event of a BEA comprehensive or other revision, CMP could have suggested such a procedure at the time ARP 2000 was being adopted. The OPA argues that CMP knew of such revisions given that the prior ARP used the GDP-PI Inflation Index and the BEA was conducting a comprehensive review at the same time that the ARP 2000 was being considered.

The OPA argues that the Company should not be allowed to adjust rates from prior annual periods based upon revised GDP-PI figures without a detailed investigation of those revisions on other factors in the formula, most notably the

X-factor, or productivity offset. The OPA notes in its brief that the GDP-PI is an economy-wide measure of inflation which may or may not provide an accurate representation of the impact of inflation on an electric utility's costs. The GDP-PI is a fair representation of the impact of inflation on an electric utility's costs only if input prices and productivity in the electric industry sector change at the same rate as they change in the overall economy. The Public Advocate claims that it considered the differential in price changes during the ARP 2000 negotiations and that the OPA's judgment was based upon the information that was available at the time. If the OPA thought that the Commission would reach back to prior periods to adjust the inflation index as a result of a BEA revision, the OPA would have sought language requiring that other factors be considered at the same time.

Finally, the OPA notes that no retroactive adjustments were made prior to annual ARP adjustments when the BEA made its previous comprehensive revision to the GDP and GDP-PI in 1999. The OPA points to the Company's response to ODR-01-02, which indicates that in years 1994, 1995, 1996, 1997 and 1998, the actual GDP-PI figures used in the annual price adjustments were 2.92%, 2.55%, 2.12%, 1.78% and 0.98%, respectively. The attachment further indicates that the revised GDP-PI figures for those years are 2.17%, 1.95%, 1.86%, 1.49% and 1.08%, respectively. Such data indicates then that in 1994, 1995, 1996 and 1997 the actual price adjustments were 0.75%, 0.60%, 0.26% and 0.29% higher respectively, while the 1998 adjustment was 0.10% lower, relative to what the price adjustments would be if one were to employ the revised BEA GDP-PI figures in calculating the annual price adjustments.

The OPA does not propose retroactive correction for the 1994 to 2000 period, but does contest the retroactive correction that the Company proposes. The OPA contends that the fact that GDP-PI figures relied upon in ratemaking during the 1994 to 2001 period would have resulted in annual over-recoveries of 1.7% in each year from 1998 to 2001, if corrected retroactively, is relevant in considering whether to adopt the Company's proposed retroactive GDP-PI correction for 2001 and 2002.

## 2. The Transformer Replacement Issue

In its brief, the OPA states that based on its review of the information provided by CMP related to transformer removal costs, "regular labor" should not be considered incremental since the employees performing this work would be paid anyway. Similarly, "labor overheads" should not be included since these expenses exist without regard to the transformer program. Although the Company claims that it has added about 20 line workers at CMP since rates were set in Docket No. 97-580, CMP has not demonstrated that the 20 line workers were hired solely as a result of the transformer removal project. Thus, CMP has not proven a connection between these new hires and the transformer replacement program. In addition, the OPA noted that the category of costs labeled "personal mileage," while small, should not be viewed as incremental and also questioned whether the categories of costs categorized as "meals" and "company vehicle" were incremental.

The OPA concluded that since the Company would be paying the costs it has identified as non-incremental to its employees regardless of the existence of the transformer replacement program, such costs should not be candidates for additional deferral for later inclusion in rates.

## V. DECISION

### A. The Inflation Index Adjustment

Paragraph 6 of the Stipulation we approved in *Central Maine Power Company, Request for Approval of Alternative Rate Plan (Post-Merger) "ARP 2000"*, *Order Approving Stipulation*, Docket No. 99-666 (Nov. 16, 2000) provides:

Inflation Index: The index used for measuring inflation will be the Gross Domestic Product - Price Index ("GDP-PI"), chain type, as reported by the U.S. Department of Commerce, Bureau of Economic Analysis. The annual inflation rate will be calculated as the percentage change in the fourth quarter of the most recent year from the fourth quarter for the preceding year.

The OPA argues that the language of the Stipulation is unambiguous. Therefore, there is no need at this time to go back to examine what either party may have had in mind at the time the Stipulation was entered into since the language of the Stipulation is clear.

We note initially that where a settlement agreement is filed with the Commission and approved by the Commission it loses its status as strictly a private contract and takes on a public interest gloss. *Cajun Electric Power Cooperative v. FERC*, 924 F.2d 1132, 1135 (D.C. Cir. 1991). If the language of the settlement agreement is unambiguous, the Commission need go no further than the agreement itself. If the agreement is ambiguous, however, we will reconcile the ambiguity, drawing upon our technical expertise and our view of the public interest, as well as relying on traditional tools of contractual and statutory construction. *Cajun, Id.*

In looking at the definition of the inflation index set forth in the Stipulation, we first note that the Department of Commerce's BEA introduced the "chain-weighted" version of the Gross Domestic Product Price index (GDP-PI) in 1996 as a replacement for the "fixed-weighted" version then in use. BEA maintains that the chain-weighted GDP-PI more accurately measures price changes and spending patterns in the economy.<sup>5</sup> In its normal course of reporting economic indicators, BEA regularly makes

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<sup>5</sup> In simple terms, the "fixed-weighted" version of the price index weighted the individual components comprising GDP using a specified base year (for example 1996 = 100) to value each individual component's contribution to total GDP. This served to introduce a bias in the direction of the base year's valuations that grew more pronounced over time. Thus, the further away one measures from the base year (in

revisions to its price (GDP-PI) and quantity (Real GDP) indexes. There are several different levels of revision that are relevant for our purposes including “comprehensive” revisions, “annual” revisions and quarterly releases (advance, preliminary and final estimates).

The so-called “quarterly releases” issued by BEA are most relevant to CMP’s annual ARP price change filings both in ARP 2000 and in ARP 95 since these releases were used to indicate and compare the appropriate fourth quarter GDP-PI’s used in CMP’s annual price change formula. The name “quarterly release” is somewhat misleading because while it refers to end-of-quarter data, it is actually released monthly. To illustrate, the fourth quarter 2003 *Advance* estimate was released on January 30, 2004. On February 27, 2004, the fourth quarter 2003 *Preliminary* estimate was released. These were followed on March 25, 2004 by the fourth quarter 2003 *Final* estimate. According to BEA’s website, these quarterly release dates have been in use since at least 1997.

We agree with the OPA that the language of the Stipulation concerning the mathematics of calculating the inflation index (taking the percentage change between the fourth quarter for the preceding year and the fourth quarter for the most recent year) is clear as is the source of such numbers (BEA). As noted above however, BEA publishes several different GDP-PI calculations for the same time period. The Stipulation does not state which of the BEA publications should be used in performing the annual index calculation. Nevertheless, the most straightforward reading of this language is that, when calculating the change from December to December, the same BEA publication (of whatever vintage) should be used. The Stipulation requires a calculation based on the level of inflation over the course of the prior year, and not one based on the cumulative change from any particular starting point.

Moreover, the course of dealings among stipulating parties supports the “year over year with the same BEA publication” approach. See *Blue Rock Industries v. Raymond International, Inc.*, 325, A.2d 66, 74 (Me. 1974). Throughout the term of ARP 95, and thus far in ARP 2000, CMP’s annual price change filing has been made by March 15 for effect the following July 1. Based on this filing date, CMP has been including the fourth quarter (year “X”) *preliminary* estimates from late February/early March in its original filing and then has used the fourth quarter (also year “X”) *final* estimate from late March/early April to supplement its filing prior to the Commission’s ruling on the annual price change. This year was no different. The fourth quarter 2003 *preliminary* estimate filed on March 15, 2004, showed the GDP-PI at 106.187 and the

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either direction), the less comparable the out-years are to the base year in terms of prices and quantities. The “chain-weighting” of components essentially eliminates this bias by using up-to-date weightings of component valuations, thus making all numbers in a series more comparable to each other. Chain-weighting of price and quantity indexes is now the norm for BEA and has gained popularity among most industrialized countries.

fourth quarter 2002 estimate (from the Comprehensive Revision released in December 2003) at 104.571, a year-over-year change of 1.55%. In its response to ODR 02-07, CMP filed BEA's March 25, 2004 release of the fourth quarter 2003 *Final* estimate indicating the GDP-PI to be 106.270 versus an unchanged fourth quarter 2002 estimate of 104.571, a year-over-year change of 1.62%. Thus, we find that when the language of the ARP 2000 Stipulation is looked at in terms of the custom and usage developed by the parties during the past nine years, the methodology of calculating the annual inflation index for purposes of the annual price change is clear and that the fourth-quarter to fourth-quarter change is to be based on the BEA's "final" estimate filed in late March/early April.

The Company in this case, however, has asked that we go beyond the annual inflation adjustment and go back to prior years' calculations to capture the comprehensive revision to the GDP-PI completed by the BEA in December 2003. BEA's "comprehensive revision" is, as indicated by its title, the most extensive revision undertaken and is done every four to five years. The last four comprehensive revisions were released in December 2003, December 1999, February 1996, and December 1991. Among the topics addressed in the comprehensive revisions are major items similar to those noted in CMP's Brief as well as statistical and definitional changes. The move from fixed-weighted to chain-weighted indexes, discussed above, was the result of the comprehensive revision completed in 1996.<sup>6</sup> Likewise, the move from using Gross National Product (GNP) to using GDP as the primary measure of economic activity came out of 1991's comprehensive revision. Another feature of the comprehensive revision is that both the GDP and GDP-PI data series' are typically adjusted for all historical years (and quarters).

In addition to the comprehensive revisions to the GDP-PI such as the one carried out this year by BEA, the BEA performs an annual revision to its GDP-PI calculation. According to the BEA, the scope of the changes and number of years affected are the main differences between the comprehensive and the annual revisions. "Annual revisions" are typically published each August and include annual and quarterly revisions starting with the end of the most recent calendar year and working back three years. For example, the annual revision published in August 2002 showed revisions in annual numbers from 1999 through 2001 and in quarterly numbers from the end of the first quarter (March 31) 1999 up to and including the end of the first quarter of 2002. Annual revisions to price and quantity indexes are characterized by BEA as "estimates," but they incorporate the most recent and complete source data available at that date.

The ARP 2000 Stipulation itself contains no language or procedure for incorporating the effects of BEA's revisions to prior year's indexes. CMP argues that since the Stipulation contains no express language prohibiting or restricting its ability to

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<sup>6</sup> Once the BEA moved to the chain-weighted GDP-PI index, it stopped publishing the fixed-weighted GDP-PI index. The move to the chain-weighted index was accepted by the parties and the Commission as the suitable index to measure the year-to-year change in inflation in *Central Maine Power Company, Annual Price Change Pursuant to the Alternative Rate Plan*, Docket No. 96-599 at 2 and 10.

update the inflation index, CMP is authorized to make the changes proposed. CMP argues that Staff could easily have insisted on adding a restrictive parenthetical such as "the inflation index will be calculated as the percentage change in the fourth quarter (as of April 1<sup>st</sup>) of the most recent year from the fourth quarter of the preceding year." In support of this position, CMP cites three purchase power agreements (PPAs) which have been filed with the Commission and which contain a date certain for the calculation of the inflation index.

We reject CMP's argument that the lack of restrictive language creates a presumption authorizing CMP's proposed inflation updates. The ARP Stipulation itself, approved by the Commission in Docket No. 99-666, is a rather detailed document which sets out the terms under which CMP's rates may be adjusted during the course of the ARP. The Stipulation does not contain authorizing language which would permit the Company, or any other party, to change or add pricing rules unless expressly prohibited. Given the language of the Stipulation, we are not prepared to read the Stipulation's silence on the subject as authorizing the change proposed by CMP.

The PPAs cited by CMP do contain a provision fixing the date for the calculation of the change in the relevant inflation index. The PPAs cited by CMP also make specific provisions for how changes in the base year should be reflected in the price change mechanism. More importantly, the PPAs were entered into between CMP and entities who were not parties to the ARP 2000 Stipulation. The ARP 2000 Stipulation contains no such provision, however. We conclude that the PPAs between CMP and other third party entities provide no probative evidence as to the intent of the parties to the ARP 2000 Stipulation.

The Company places great weight on the argument that the ARP regulatory compact is predicated on the use of the most accurate inflation index available. Again, we find the parties' conduct during the ARP provides insight here as to how the ARP was intended to function. No party during the course of the ARP 2000 or ARP 95 proceedings proposed to incorporate the effect on prior years' inflation indexes of either BEA's annual or comprehensive revisions. Nor have the parties, including CMP, attempted to include the effect of BEA's annual and comprehensive revisions on prior years' inflation indexes in any previous annual ARP review.

CMP asserts correctly that it has as part of prior years' annual reviews incorporated the effect of the BEA's revisions in the baseline December number which is used to calculate the next year's price change. This practice, which has been accepted by the parties, and is in fact being done with respect to this year's price change, is markedly different from reflecting the effect of such changes on prior years' inflation indexes. Had the parties placed preeminent weight on the accuracy of the inflation index as argued by CMP, they could have incorporated a specific provision to

reflect the effects of the comprehensive and annual revisions on the prior years' indexes.<sup>7</sup> The parties did not do so, however.

As noted previously, the annual revisions done each August by the BEA revise the GPD-PI for the prior three years. CMP attempts to distinguish these revisions from the comprehensive revision on the basis of the size of revisions. There is no basis in the Stipulation, however, to distinguish between the two different types of revisions. If the accuracy of the inflation index was an absolute imperative as CMP argues, it is not clear why even small changes to prior years inflation indices should not have been previously incorporated into subsequent rate changes.

CMP argues that it could not have incorporated BEA's last comprehensive revision since the revision was completed after the last price change in ARP 95. CMP does not explain, however, why it did not propose to incorporate the impact of the previous comprehensive revision done by the BEA in February, 1996 on the prior price change made during ARP 95.

In its exceptions to the Hearing Examiner's Report, the Company argues that if the intent of the parties is not clear, one must look to the purpose of the Stipulation, and since the purpose was to have as accurate an inflation adjustment as possible, the revision it is seeking should be made. As a preliminary matter, we question the premise of CMP's argument. The Stipulation sets forth the methodology for making the inflation adjustment, and nothing in the agreement indicates that once made, the adjustment should be altered even on a prospective basis. Thus, we do not agree that there is an ambiguity in the Stipulation warranting the analysis preferred by CMP.

Even if we were to accept CMP's premise for the sake of argument, we do not believe it would warrant a different result. To the extent the Company is suggesting that this is a matter of using an accurate as opposed to an inaccurate percentage, it greatly overstates the case. The effect of the BEA's comprehensive revision is to replace one estimate of inflation with another (presumably better) estimate of inflation, which will eventually be replaced with yet another (presumably even better) estimate of inflation. If the old estimate is deemed "inaccurate," then we are condemned to using inaccurate percentages under any circumstances since the BEA will still be revising the estimates long after CMP's current rate plan has expired.

To the extent there are reasons to adopt CMP's approach, they must be weighed against its potential to interfere with other policy objectives. As we have stated in the past, two of the principle objectives of price cap plans are to enhance the likelihood of rate stability and to reduce regulatory "administration" costs. *Central Maine Power Company, Proposed Increase in Rates*, Docket No. 92-345 at 130 (Dec. 14,

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<sup>7</sup> For example, the parties to the Stipulation could have, but did not, reflect the impact of such changes on prior years' inflation indexes by calculating the change in inflation through a set base year rather than the December to December methodology agreed to.

1993). Consistent with achieving those objectives, we further indicated in that case that we envision the annual ARP review to be a limited proceeding, restricted to determining the mandated costs that can be passed through to consumers, verifying the profit sharing and price-cap rate adjustment and evaluating the Company's quality-of-service performance during the previous year. *Id.* at 137. In our view, revising already determined and applied inflation adjustments runs counter to the goals of rate stability and simplicity of administration.

It bears noting that what CMP now suggests is an inaccurate inflation adjustment benefited the Company in the first ARP. As a result of this very same "mis-estimation" of inflation during that ARP, CMP's rates were 1.8% higher than they would have been,<sup>8</sup> while they will be approximately .61% "too low" during the current ARP. These numbers only reinforce the point that because inflation revisions continue long after the expiration of rate plans, we will inevitably use an "inaccurate" inflation adjustment even under CMP's approach, a phenomenon that worked to CMP's considerable advantage in its initial ARP.

This is not to say that we would have rejected a stipulation that expressly called for the type of adjustment that CMP is seeking here, as we think reasonable people can disagree about whether the value of using updated numbers (at least until the ARP expires) outweighs the rate stability and administrative ease benefits of leaving the estimates in place once they are made. In the absence of such an express provision, however, we do not find the argument in favor of CMP's approach so compelling that we are willing to read it into the Stipulation.

1. Transformer Replacement Costs

As state above, the parties in the 2003 annual review reserved the right to investigate whether transformer removal costs were truly incremental so as to be included in rates. The OPA in this case argues that CMP has not demonstrated that 20 additional line workers were hired solely a result of the transformer replacement project and thus the cost of the additional workers should not be considered incremental.

In *Public Utilities Commission, Investigation of Stranded Cost Recovery Transmission and Distribution Utility Revenue Requirements and Rate Design of Bangor Hydro-Electric Company, Accounting Order*, Docket No. 97-596 (Sept. 8, 1999), the Commission addressed the issue of what portion of an employee's time spent on a task which was considered to be mandated and the proper subject of an accounting order should be considered incremental and thus subject to deferral. We concluded in that case that where a utility brings on new employees (on a net basis) or uses outside contractors to perform the tasks, such costs should be viewed as wholly incremental and the utility should be allowed full recovery.

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<sup>8</sup> Page 9, footnote 5 of the OPA's Brief shows a calculation of 1.71%. The Hearing Examiner believes that the compounding effect built into the price formula actually raises the "overage" to 1.83%.

For existing employees, the Commission did not believe that 100% of an employee's time spent on a new task could be saved or used to perform other tasks of equivalent value. In other words, not every moment on the job spent by every employee is fully productive. In addition, we noted that to the extent that ratepayers are already paying for some of these costs in existing rates, an accounting order should not be used as a vehicle for collecting twice from ratepayers for the same expense. *Id.* at 6. On the other hand, we found that by using current staff, the Company is avoiding the costs of hiring new employees or contractors, thereby achieving savings for ratepayers. The Commission concluded that the utility should, therefore, recover 50% of the directly assignable costs resulting from the use of existing employees to perform the mandated task. In reaching this conclusion, the Commission stated:

We believe that the sharing mechanism which we adopt will provide the Company with the proper incentives. While the Company will receive from ratepayers 100 cents on the dollar for amounts spent on new hires or consultants retained to perform restructuring work, it will also pay out an additional 100 cents on the dollar. By using an existing employee whose salary is arguably already in rates, the Company will receive 50 cents on the dollar for costs associated with that part of the employees' time devoted to restructuring. That 50 cents, however, is in addition to the dollar of salary which is already embedded in the Company's rates. Thus, every dollar in avoided new employee costs will result in a 50-cent benefit for the Company and a 50-cent savings for its ratepayers.

*Id.* at 7.

In the case before us, the Company has claimed that it has hired 20 new line workers, at least in part, as a result of 38 M.R.S.A. § 419-B. The OPA claims that the Company has not demonstrated that these new workers were hired as a result of the program. The OPA has also challenged whether certain other cost categories, such as meals and vehicles, should be classified as incremental costs.

We do not believe that we can resolve these factual disputes, as well as the issue of whether, or to what extent, the 20 new line workers hired by the Company represented new net hires not included in rates, on the record before us. In addition, we note that it appears, based on the Company's responses to questions from our Advisory Staff at the April 28, 2004 technical conference, that the Company's deferrals for removal costs are based on projections and not actual costs and that in calculating the return component on its replacement transformer units, the Company is not accounting for the effect of accumulated depreciation or declining rate base.

We therefore believe it is appropriate to refer these issues back to the Examiner for further proceedings to address the questions noted above. We will allow CMP to include the amounts proposed for this item in this year's rate change

subject to the conditions of reconciliation as set forth in *Central Maine Power Company, Review (Post-Merger) "ARP 2000"*, Order Approving Stipulation, Docket No. 2003-179 (June 24, 2003).

Dated at Augusta, Maine, this 23<sup>rd</sup> day of June, 2004.

BY ORDER OF THE COMMISSION

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Dennis L. Keschl  
Administrative Director

COMMISSIONERS VOTING FOR:      Welch  
                                                 Diamond  
                                                 Reishus

## NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.
2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within **21 days** of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Appellate Procedure.
3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.

**APPENDIX A**

On March 15, 2004, CMP submitted its Annual Alternative Rate Plan (ARP) filing pursuant to the requirements of the ARP 2000 rate plan. A Notice of Proceeding which provided interested persons with an opportunity to intervene in this matter was issued on March 16, 2004. The Office of the Public Advocate (OPA) and the Industrial Energy Consumer Group (IECG) filed timely petitions to intervene. These petitions were granted by the Examiner on April 5, 2004.

An initial case conference was held on April 1, 2004. Pursuant to the schedule developed at the case conference, technical conferences on CMP's filing were held on April 7, 2004 and April 28, 2004. A settlement conference was held immediately following the conclusion of the April 28th technical conference.

Based on the discussions at the settlement conference, the parties and the Examiner concluded that it would not be possible to resolve all issues in this case informally. Specifically, the issues of the Company's proposal to incorporate changes to past GDP-PI calculations as part of this price change, as well as the Company's classification of what costs related to the Company's PCB transformer replacement program are incremental and thus eligible for deferral and recovery from ratepayers would need to be adjudicated.<sup>9</sup>

The parties agreed that evidentiary hearings on these issues were not necessary. The parties and the Advisory Staff proposed items for the written record in this case on May 10, 2004, and a case conference was held on May 12, 2004 to address any evidentiary issues. By stipulation, all data responses, technical conference transcripts in this case, and CMP's annual ARP filing submitted on March 15, 2004 along with two articles discussing the calculation of the GDP-PI were admitted. In addition, by stipulation, administrative notice was taken of the filings and records in Docket Nos. 92-345 (II), 95-599, 96-599, 97-116, 97-599, 98-221, 2002-124 and 2003-179.

As part of its May 10, 2004 list of proposed evidence, CMP proposed that the Third Amendment to the Power Purchase Agreement (PPA) between Barker Hydro Company and Central Maine Power Company dated January 24, 2000 be admitted. At the May 12<sup>th</sup> case conference, the OPA objected to the admission of this document on relevance grounds. Since the document in question was not submitted with CMP's evidentiary proposal, the Examiner requested that the Bench, as well as the parties, be provided copies prior to the issuance of a ruling.

On May 13, 2004, CMP submitted the Barker Hydro Company contract as well as PPAs with Brassau Hydro-Electric and Scientific Energy and Recycling Company which the Company also proposed be admitted. A follow-up conference to provide additional opportunity for argument on this issue was held on May 13, 2004. At such time, the

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<sup>9</sup> The parties have agreed to submit a partial stipulation on all other issues.

OPA again restated its relevance arguments. Counsel for CMP argued that the proposed evidence went to the question of CMP's state of the mind at the time of the APP 2000 Stipulation. Counsel for CMP also requested that the Company be allowed to further demonstrate the relevance of the PPAs in its brief. CMP's request that it be allowed to argue the PPAs in its brief was granted. If the evidence were later found to be irrelevant, such arguments would be stricken.

On May 17, 2004, CMP and the OPA submitted briefs in support of their positions on the contested issues in this case. Following the submission of briefs, the OPA withdrew its objection to CMP's proposed admission of the three PPAs. There being no objection, the three PPAs submitted by CMP were admitted by the Hearing Examiner.

On May 27, 2004, the Hearing Examiner issued his Report in this matter. On June 8, 2004, CMP and the OPA filed their exceptions to the Examiner's Report.